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BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

---------- In the Matter of ----------	)	
	)	
PUBLIC UTILITIES COMMISSION	)	DOCKET NO. 05-0002
	)	
Instituting a Proceeding to Investigate the Issues and Requirements Raised by, and Contained in, Hawaii Revised Statutes 486H, as Amended	)	

SHELL OIL COMPANY'S POSITION STATEMENT

AND

CERTIFICATE OF SERVICE

FILED

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PUBLIC UTILITIES COMMISSION

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SHELL OIL COMPANY'S POSITION STATEMENT

I. INTRODUCTION

The stated objective of the 2004 amendments to the gas cap law was "to enhance the consumer welfare by fostering the opportunity for prices that reflect and correlate with competitive market conditions." *See* 2004 Haw. Sess. Laws, Act 242 § 1.

Shell Oil Company respectfully submits its position statement to explain why the current legislation and the recommendations put forth by the Public Utilities Commission ("PUC")'s consultant ICF Consulting, LLC ("ICF") fail to support the intent of the legislature, and in-fact heightens the risk for adverse impacts to the gasoline consumers of the State.

In January of 2005, this investigative docket was opened "to examine the issues and requirements raised by, and contained in, HRS Chapter 486H, as amended." *See* Order No. 21525 at p. 6, PUC Docket No. 05-0002. More specifically, the PUC was tasked to "[e]xamin[e] the effect, impact and appropriateness" of the material aspects of Haw. Rev. Stat. Chapter 486, as amended by Act 242. *Id.* at pp. 2-4 (emphasis added).

By all accounts, the objectives of this proceeding have been met. Through the extensive examination and investigation taken in this proceeding, all parties involved - including the PUC and ICF – now know much more about the proposed law than they did prior to the start of this process.

This investigation has uncovered serious and material flaws in both the proposed law's structure and procedures taken to implement this law. This leads to only one conclusion: based upon the record of this case and in light of the present circumstances, the PUC cannot recommend that this law take effect on its scheduled implementation date of September 1, 2005.

While Shell's findings and positions on the effect, impact, and appropriateness are presented at length and in detail herein, some major points established through this investigative process that threaten to adversely impact the welfare of the gasoline consumers of the State of Hawaii are as follows.

A. Supply Impact Not Evaluated

Haw. Rev. Stat. Chapter 486H as currently drafted and the ICF report submitted herein ("ICF Report") have not made any attempt to understand the impact to Hawaii gasoline supplies if the price cap goes into effect. While ICF acknowledged that gas cap implementation may "jeopardize supply," it did not analyze in any detail, the scope or effect this impact will have on refiners, wholesalers, jobbers, marketers, and retailers and, perhaps more importantly, the gasoline consumers of the State. In point of fact, ICF identified that there were significant supply risks, but chose not to understand those risks, claiming it was outside the scope of their assignment.

Shell believes that Hawaii's consumers deserve a through understanding of the potential impacts before the legislation is implemented. The risk to Hawaii's consumers should not be subject to economic experimentation unless the outcome is more certain.

B. Ethanol Blending Requirement in April 2006

Hawaii gasoline is mandated to contain ethanol in April of 2006. ICF concedes that the timing of the gas cap and ethanol laws create an "extraordinary and legitimate concern among marketers and refiners."

Haw. Rev. Stat. Chapter 486H does not address the mechanics of implementing the gas cap once ethanol is required. Likewise, although ICF acknowledges that ethanol "is clearly a factor which may need to be considered by the Commission in future Gas Cap Management" it chose not to address this issue in its Report by taking the position that it was outside the scope of its assignment.

Through this investigation, ICF has now acknowledged that within a year of gas cap implementation, its price cap formula and monitoring process recommended in the ICF Report will have to be changed to account for the ethanol impact. Moreover, ICF candidly admits that it does not know how its formula will be calculated once ethanol blending occurs. Accordingly, ICF now recommends against full implementation of the gas cap law.

Shell believes that the significant issues surrounding ethanol blending and the impact to Hawaii fuel supply have not been given the consideration and analysis that is warranted.

C. Impact To Neighbor Islands And Remote Areas

Haw. Rev. Stat. Chapter 486H and the ICF Report have not properly explained or addressed the impact to gasoline stations, market participants, and gasoline consumers on the neighbor islands and remote areas. HRS Chapter 486H and the ICF Report ignore these areas where higher costs create economic conditions that would likely lead to the closure of service stations if the gas cap is implemented. Although the statute and ICF's recommendations seek to make the proposed zone adjustment concept work on an average uplift basis that covers costs and profit, they do not address the vital need for marketers to recover reasonable returns for their operations in remote areas.

In its Report, ICF specifically recognizes the risk that the implementation of the gas cap law could lead to gasoline marketers and/or suppliers deciding to cease operations in remote areas on the neighbor island. ICF agrees that it would be "reasonable and prudent" for an analysis to understand this impact to be fully performed prior to the implementation of the price cap law. However, ICF performed no analysis or study to assess this risk.

D. The Mandatory Legislative Task Force That Was Never Convened

This investigation also uncovered that the Legislature, in clear violation of Act 242, failed to convene a mandatory legislative task force to address the impact of the gasoline price cap on the neighbor islands. No mandatory legislative task force was ever convened. Consequently, the task force did not conduct the investigation and prepare the reports required by Act 242. The investigation and reports were necessary to assess the specialized impact of the gasoline price cap on the neighbor islands. More specifically, the task force was supposed to ascertain the neighbor island impacts of the gasoline price cap and make recommendations – including any proposed amendments to the law to address these impacts - so that the 2005 Legislature could enact appropriate legislation to address these impacts. This legislative mandate was inexplicably ignored. Not surprisingly, the public hearings held across the State in this investigative docket served to confirm that there are serious material risks to the market participants and consumers on the neighbor islands and remote areas throughout the State. However, the current state of this law is not equipped to address these impacts and risks. Shell submits that the PUC cannot allow the law to take effect until the clear and mandatory provisions of Act 242 are followed.

E. Recommendation

As will be explained more fully below, the investigative process has created more questions than answers. It has uncovered significant problems with the proposed methodology, and confirmed known – but unstudied – risks that simply cannot be ignored. That ICF can only recommend that its formula be implemented on a "calculation and monitor" basis, underscores that the implementation of this law is badly premature. The State is simply not prepared to face the serious risks that may arise if this law is allowed to take effect.

The "investigative" phase of this proceeding is fast reaching its conclusion. It is now up to the PUC to act under Haw. Rev. Stat. § 486H-13(n) and "report to the governor and the legislature, in a timely manner, on any significant aberrations, trends, or conditions that may adversely impact the gasoline consumers in the State."

Accordingly, Shell hereby respectfully requests that the PUC recommend that the Governor invoke her emergency powers to delay implementation of Haw. Rev. Stat. Chapter 486H, until a full and complete evaluation is prepared to properly address all of the critical issues raised herein.

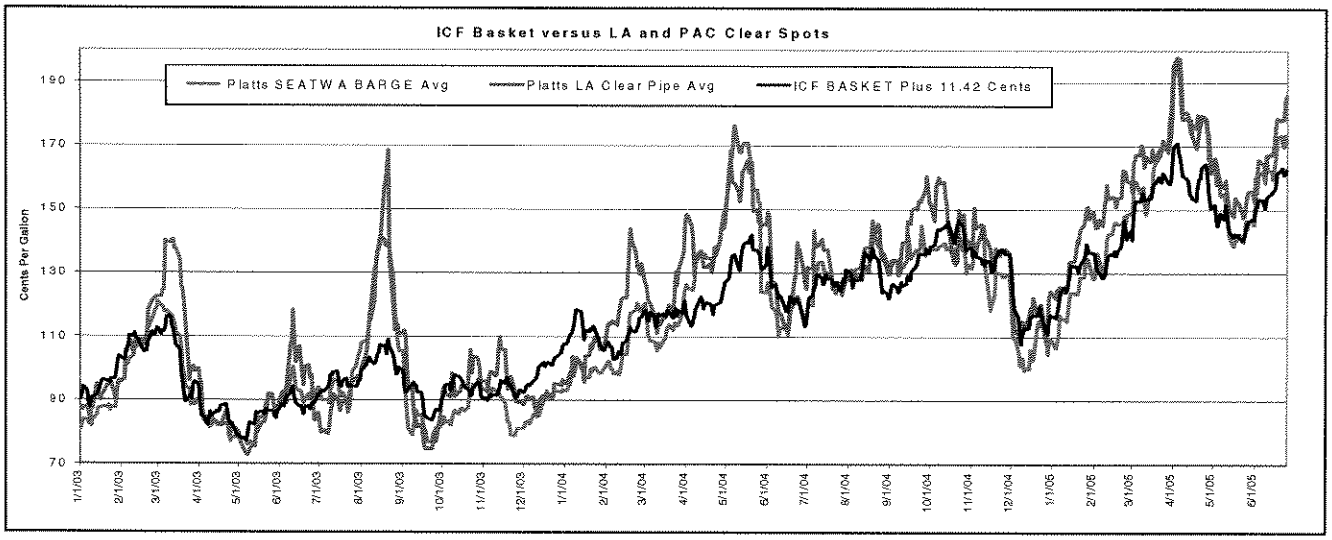
II. DISCUSSION ON THE PROPOSED METHODOLOGY OFFERED UNDER HAW. REV. STAT. § 486H-13 AND THE ICF REPORT

A. The Import Parity Concept Sought to be Utilized is Flawed

Haw. Rev. Stat. § 486H-13 as currently drafted and the ICF study both recommend using a benchmark price for gasoline that includes markets in other geographies. While the stated intent is to connect Hawaii's gasoline market to "more competitive" areas, there is also an attempt to artificially lower the benchmark by excluding important West Coast trading activity. This approach may appear attractive if a gasoline supply could be guaranteed at these levels. However, energy prices are impacted by National and World events and volatility in one part of the globe cannot be ignored simply because the impact isn't desirable.

In proposing its only recommendations for establishing "import parity," ICF specifically rejected Haw. Rev. Stat. § 486H-13(c) sources for establishing a baseline price as "fundamentally not a realistic assessment of competitive alternatives." *See* ICF's Response to SHELL-IR-18. ICF also deemed that the proposed location adjustment factor in Haw. Rev. Stat. § 486H-13(d) "is not an appropriate factor to be utilized" as well. *See* ICF's Response to SHELL-IR-23.

Assuming that the ICF-recommended formula is utilized as the baseline to establish the "import parity" price, Shell believes that the critical economic question is whether the local refiners would be satisfied with the selling price, or whether a non-refiner could realistically import product for re-sale at the ICF-recommended levels.



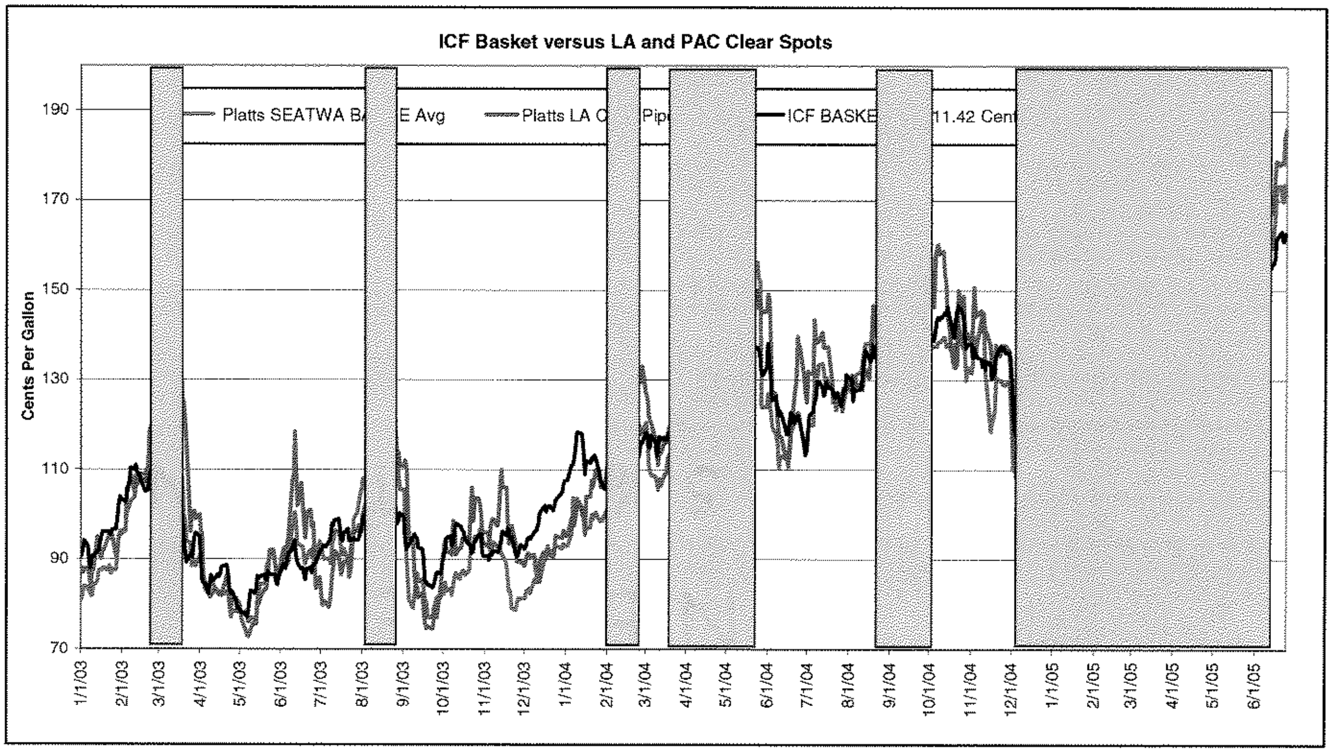
In the chart set forth above, utilizing data obtained sourced from Platt's information service, the ICF basket price is plotted on a daily basis from January 2003 through mid-June 2005. The black line represents the ICF price, with the red and blue lines representing the Los Angeles and Seattle spot markets respectively. All products are quoted using "conventional" gasoline, so the impact of CARB quality gasoline is eliminated.

ICF has utilized a theory that the "fair" price for gasoline should represent a spot market price plus reasonable transportation. The data clearly displays that all prices follow similar trends, but the ICF formula has considerably less volatility than either Los Angeles or Seattle. An argument may be raised that this picture represents exactly what Hawaii's legislature intended when it passed the law - lower benchmark prices, but without the volatility of the West Coast. However, ICF's logic has two fatal flaws that will expose Hawaii consumers to increased supply risk.

First, ICF has intentionally ignored the West Coast impact on Hawaii's gasoline pricing. Second, they used "averaging" logic to represent volatile markets.

The impact appears subtle if the numbers are evaluated over time. Indeed, in the preceding graph, the "average" Seattle spot price above is only 1 cent per gallon higher than the ICF formula over the same period. However, it is an accepted principal within the petroleum industry that market forces inevitably create supply and demand differences, which cause the Los Angeles or Seattle prices to be higher or lower than the ICF formula. When this type of volatility is sustained for a period of time, refiners and traders will work to optimize their short-term profit opportunity and move product to the market that offers the best price.

The following chart is a duplicate of the spot market chart above, but yellow shading has been added to highlight those periods when the ICF formula price would not compete favorably compared to a refiner's alternative on the West Coast. During these periods, Caribbean or Far East refiners would achieve a higher selling price by moving available product to the West Coast. Similarly, during these periods, Hawaii refiners would also have an incentive to export Hawaii gasoline to West Coast markets.



Opponents of the view may doubt that Hawaii refiners could react swiftly enough to arrange shipping and take advantage of higher West Coast prices, an argument which may have some merit if the higher prices last for a short period of time. However, the actual historic data, as set forth above, clearly shows extended periods of time when West Coast prices are substantially above the ICF cap.

Moreover, noted economists confirm that the proposed gas cap law may cause shortages "because the regulations will divert global supplies away from Hawaii when markets are tight, as they are today, and prompt firms to separately and independently reduce supplies during periods of surplus, and wait until they can earn the guaranteed margin." *See* Letter dated May 10, 2005 from Phillip K. Verleger, Jr.[1] to the PUC. ICF concedes that "[t]here is always that possibility" that Hawaii refiners would occasionally realize greater profit margins by exporting Hawaii gasoline rather than selling it in Hawaii, but admits that it "did not consider or analyze the impact of the price cap when the proposed import parity price is lower than a local refiners export opportunity." *See* ICF's Response to SHELL-IR-10; ICF's Response to SHELL-IR-11. Given these circumstances, and in light of the data presented herein, Shell believes that should the State proceed with implementation of this price cap law based upon the "import parity" principals currently being proposed, local refiners will find a way to capture this value, to the detriment of local supply stability.

Shell also submits that if Hawaii's benchmark price refuses to acknowledge the significant impact of West Coast gasoline markets when establishing the cap, Hawaii supply will be impacted. As a non-refiner in the local market, Shell is extremely concerned that the proposed benchmarks will set a false and arbitrary value on gasoline, adding a level of unacceptable risk to Hawaii's supply continuity.

B. <u>The Margin Factor Concept Sought to be Utilized is Flawed</u>

Haw. Rev. Stat. § 486H-13(e) as currently drafted and the ICF study both provide a mechanism to define the allowable marketing margin for suppliers. The ICF Report correctly identified a significant flaw in the original law, whereby there is no provision for the multiple channels of distribution that exist in the marketplace. ICF noted that Haw. Rev. Stat. § 486H-13(e) is not "appropriate" insofar as "1) it assumes only one

[1] The letter submitted by PKVerleger LLC to the PUC "to warn [the PUC] of the likely consequences of this legislation in its attempt to regulate gasoline margins[,]" as was made part of the official record of this case by way transmittal letter dated June 22, 2005 from Commission Counsel to the parties.

class of trade exists for wholesale sales, and does not clearly identify which class of trade applies, and 2) it assumes that marketing margins are fixed, where in fact . . . marketing margins can and do vary over time." *See* ICF's Response to SHELL-IR-49.

In view of these reasons, ICF's proposal sought to accommodate the multiple levels of wholesale gasoline transactions, designating different factors for bulk, branded rack, unbranded rack, and DTW transactions. However, while ICF's recommended framework is more aligned with the actual industry structure, it too contains errors and flaws that will create unintended consequences at the expense of Hawaii consumers.

ICF has proposed caps on marketing margins based on rough estimates of mainland margins. While this is arguably a reasonable approach, the record of this case establishes that ICF was severely constrained by financial and time limitations that prevented a proper and thorough analysis, which has lead to flawed conclusions that must be rejected.

ICF has now admitted that *its entire "data acquisition" project budget, which is the budget for "obtaining the data used to establish margins and adjustments in the Report," was a mere $6,000*, an unacceptably low amount for the scope of work it was retained to perform in this case. *See* ICF's Response to Tesoro-IR-33. As a result, in place of detailed and localized data normally available and utilized within the industry, ICF was instead forced to use publicly available information from the Energy Information Administration ("EIA").

Indeed, Shell submits that EIA data, while useful in understanding trends in a broad sense, does not have the granularity necessary to determine the absolute values for

Hawaii's price cap. ICF itself, admits that even though more specific data was available to be utilized, because of extreme *cost* and *time* constraints of their retention, this better data was not utilized:

> ICF's use of EIA data involves utilizing state average data from the IEA (as reported to the EIA by Marketers & Refiners). The alternative to the EIA data would have been regional (i.e. localized to areas consistent with the Rack locations) as provided by a Price Service such as Lundberg (neither OPIS nor Platt's tracks DTW data). *The Lundberg data provides specific information on company by company pricing on a daily basis in the region and zones within a region. It is expensive due to the granularity of the data and the potential value it provides marketers. The expense of the data would be compounded by the added time to assess the average data in a region, and the estimates of volumes needed to get a reasonable average. ICF elected to use EIA data because it appeared to be the best value in the analysis.*

ICF's Response to SHELL-IR-47 (emphasis added). By these comments, it is clear that *cost* and *time* were the primary drivers for selecting data to be utilized in its report, rather than *quality* and *reliability*. Unfortunately, the inadequateness of the ICF's research budget severely impacts the quality of the data that it was able to utilize, which in-turn adversely affected the quality of the analysis now offered by ICF.

For example, EIA DTW data is reported at the State level, so ICF had to presume that marketing costs and margins were identical across an entire State. However, just like Hawaii, every State experiences different costs to serve its various geographies. Consequently, the ICF analysis inaccurately assumed that average margins could be understood by utilizing the averages reported by EIA, with little regard for localized cost variations. *See* ICF's Response to SHELL-IR-47 (noting that "The EIA data is a good statewide average, but may lose margin quality since the distribution costs (vs. Rack distribution cost in a specific locale) would need to be estimated.").

As a further matter, the ICF study selected a limited and incomplete set of markets for review. ICF intentionally limited the markets to align the analysis with the wholesale rack pricing markets. ICF also limited the view to areas served by Conventional gasoline. *See* ICF's Response to SHELL-IR-45. These restrictive criteria appear to be arbitrary as neither the existence of wholesale information, nor the type of fuel has significant bearing on the DTW margin calculation. Instead, ICF should have been more concerned with identifying US markets that have significant dealer operated networks (Seattle, Portland OR, California, Chicago, Maryland, Virginia, New York, Boston). Some mainland States also have divorcement legislation similar to Hawaii, and ICF should have placed more emphasis on these types of markets, or at least included them in the study.[2] Indeed, when ICF was asked whether or not it agrees that DTW price comparisons "would have been more meaningful to the present analysis if the comparison markets were selected where significant dealer operations existed," ICF responded that it "concurs in general with that statement." *See Id.*

While ICF uses an estimate of mainland DTW margins as the basis for its recommendation, it also recognized that "Hawaii marketers may be managing their business with higher fixed costs per gallon of sales than the Mainland markets evaluated." ICF Report at p. 42. Amazingly, despite the admission that mainland margins may not be directly comparable to Hawaii economics, ICF failed to perform any

[2]ICF concurs that states with divorcement laws similar to Hawaii such as "Maryland and/or Virginia would have been appropriate alternatives to examine." *See* ICF's Response to SHELL-IR-45.

additional analysis to understand whether the recommended margins would be sufficient to encourage a supplier to continue operating in the Hawaii market.

Regardless of whether ICF had dedicated the necessary resources to truly understand DTW margins, its recommendation to propose caps based on annual averages is flawed methodology that impacts multiple issues within ICF's study.

As with the use of averages to calculate supply costs, the use of averages to set margins lead to similar results. When an average margin is used, suppliers will analyze their networks and shed those assets that are unable to earn a reasonable return based on the average margin. In Hawaii, this likely means that service stations with higher costs will be closed. Since the final process has not yet been defined, it is impossible to say which stations are more likely to be impacted, but it is clear that the price cap law will encourage the closure of stations, and thereby reduce competition at the retail level. The impact to remote areas, where volumes are lower and costs are higher, is a significant concern.

ICF has proposed a formula to artificially lower the DTW to "mainland" standards with no recognition of higher costs, lower volumes, or the impact to competition. Clearly this seems to be contrary to the basic economic principles and the spirit of the original legislation which envisioned a mechanism for suppliers to seek adjustments where higher costs could be demonstrated. Ironically, even though the Legislature did not want the price cap to discourage competition or result in the closure of facilities, the current ICF's proposal will likely do both.

C. The Zone Adjustment Concept Sought to be Utilized is Flawed

The ICF study correctly recognized that several channels of distribution exist within the gasoline marketing industry. While their ultimate recommendation attempted to establish a logical framework to cap each level of the value chain, the work is still incomplete. Since ICF did not directly engage industry participants prior to the publication of their report, it is not surprising that significant errors and omissions exist.

For example, ICF incorrectly assumed and anticipated that bulk transfers would take place at a supplier's terminal, and therefore recommended the supplier be able to charge the entire location differential to the receiving party. Nowhere in ICF's recommendation did they anticipate a bulk seller transferring the product into the buyer's terminal. This sort of omission would allow a seller to extract the full location differential without violating the provisions of the cap, but then leave the purchaser with no legal means to cover their actual terminal costs. When presented with this scenario, ICF took a 180° turn and noted that "[t]o accommodate the different possible transaction points for Bulk sales, the table shown in Exhibit 7.1 (which is ICF's mock-up for displaying their 96 different price cap points) should be modified to provide the additional transaction points." *See* ICF's Response to SHELL-IR-63. Exhibit 7.1 of the Report is supposed to simulate what the proposed publication page will look like on the PUC's website. That ICF would be recommending structural changes to this format at this late date makes it painfully evident that gas cap implementation – at least at this point – is entirely premature.

In building on this point, through the discovery allowed to be taken in this matter, ICF has now recognized that its proposed cap formula needed to accommodate more transfer points, and has recommended against imposing caps on the bulk class of trade. *See* ICF's Response to CA-IR-1. Indeed, this is a dramatic and fundamental shift from its original recommendation and appears to be driven by a recognition that bulk sales transactions are perhaps, more complicated than they earlier thought. While Shell does not necessarily disagree with ICF's recent position, it is surprised that ICF has been so quick to concede on these points. While complexities exist, it would appear to be prudent for ICF to perform more analysis before ejecting a fundamental, structural piece of their original recommendation. Certainly, that ICF has been so quick to abandon major aspects of its analysis does not instill a high degree of confidence in the other aspects of the recommendations set forth in the ICF Report.

In addition to the bulk sales issue, ICF has recommended fixed differences between the zones based on industry average costs. In lieu of the legislative direction, ICF has recommended a cap based on the average costs for the suppliers operating in these arbitrarily designated zones. No process has been established to recognize that some suppliers have very different operating constraints (tank sizes, monthly sales volumes, etc.) that would be negatively impacted by the use of a formula based on industry average costs. In fact, ICF readily admits it did not "perform any research and/or analysis regarding the types of different operating circumstances" that could influence the difference in costs. *See* ICF's Response to SHELL-IR-62.

Again, ICF's failure to directly engage industry participants prior to the publication of their Report is a fundamental flaw that affects virtually all aspects of its published Report. In terms of ascertaining an accurate picture for suppliers operating in the different zones, should ICF's recommendations be accepted on their face, any supplier who is operating at above-average costs will be disadvantaged. If the higher costs are driven by structural issues that cannot be mitigated in the near term (i.e., tank size, dock capacity, sales volumes), some suppliers will no doubt have to consider whether it makes sense to remain in business. This effect, which will be covered in length below, is especially magnified for suppliers and operators on the neighbor islands and in remote areas throughout the State. Indeed, given the extreme complexity and widely divergent factors that necessarily exist in an island State - with islands that are separated by the Pacific Ocean – it would at a minimum, be reasonable and prudent to carefully consider the potential impact to all party participants, before implementing this section of the recommendation.

The lack of any meaningful analysis to address these complexities underscores that there is simply too risky to implement the gas cap law at the present time.

III. DISCUSSION ON THE MAJOR FACTORS AGAINST THE IMPLEMENTATION OF THE GAS CAP LAW

A. Supply Impact Not Evaluated

Haw. Rev. Stat. Chapter 486H and the ICF Report have not made any attempt to understand the impact to Hawaii gasoline supplies if the price cap goes into effect. Noted economist Phillip K. Verleger, Jr.[3] provided testimony in this proceeding, emphasizing that "[a]fter reading the ICF report I would counsel the state not to take action. The controls are not necessary in periods of surplus – but could easily reduce the supply to the

[3] It should be noted that Mr. Verleger provided this testimony in his capacity as a professional economist who regularly advises government, consumers, processors, and producers regarding market conditions. Mr. Verleger also notes that he has never testified for the petroleum industry in formal disputes with states regarding oil market conditions. *See* Letter dated May 10, 2005 from PKVerleger LLC to the PUC.

state and raise prices in tight markets such as those prevailing today." Letter dated May 10, 2005 from PKVerleger LLC to the PUC.

While Shell has explained how the analysis and assumptions utilized in its study are flawed, the ICF Report itself, and the record in this case further illustrates the fact that the supply impact (caused by the price cap implementation) has simply not been studied.

ICF admits that it did not "specifically evaluate whether or not Hawaii refiners will be financially inclined to produce premium unleaded gasoline at the proposed differential levels, or if they will have an incentive to export premium unleaded gasoline and/or blending components to the West Coast." *See* ICF's Response to SHELL-IR-52. ICF also did not consider the possibility that local refiners may elect to export premium gasoline from the State in light of recommended differentials that are set based on yearly averages, notwithstanding the fact that the spot market trades daily. *See* ICF's Response to SHELL-IR-53.

The ICF Report freely acknowledges that its recommended formula - tied directly to foreign events and contingencies - may lead to adverse effects and uncertainty on profitability levels for refiners:

> While the Legislature's desire to achieve competitive, market based gasoline price caps is much better than simply establishing a hard price cap, the Gas Cap legislation is still a disruption to the free market system. The mechanism proposed herein by the Legislature, and with ICF's recommendations, attempts to minimize those disruptions. *There will however, be situations where the gasoline price rises in the Caribbean, or Singapore markets due to events local to those markets which could impact Hawaii consumers due to the formula. Or, outages at Hawaii refineries may locally affect Hawaii supply and*

> *inventory, but the Gas Cap would not change because Hawaii's problem likely won't impact the Caribbean, USGC or Singapore markets. More critically, if imports are needed to make up the lost volume, the inability to raise prices beyond the gas cap may blunt economic replenishment, and jeopardize supply.*

ICF Report at p. 76 (emphasis added). In view of these situations, ICF admits that its recommendations could lead to "a decrease in the available supply of gasoline within the state of Hawaii[:]"

> The potential disruptions which can and do occur in refiners from time to time will usually trigger replenishment from other areas. This occurs because prices tend to rise after an outage and attract supply from other markets. Without a mechanism to raise wholesale prices after a significant outage, it may be more difficult to arrange replenishment at economic terms with a gas cap in place.
>
> There is also potential for exports of gasoline, however ICF believes that due to freight, timing, and economics, the risk of exports may not be substantial (barring a radical reduction in Hawaii demand).

ICF's Response to SHELL-IR-75(b).

ICF candidly explains the specific impact that will be faced by the two refiners within the State:

> *If the refiners view the profitability as integrated with the wholesale marketing business, the impact could be reduced profits*, particularly if the Gas Cap directionally reduces the wholesale gasoline prices as indicated in the above historic analysis. *In addition, refiners may be further impacted by the mandated ethanol legislation in 2006, which could require refineries to reduce gasoline production to manage supply. These two changes may push Hawaii's refiners to closely examine refinery profitability and sustainability.*

> *ICF believes that it is important to Hawaii's long term energy security that these two refineries be financially sound. A decision to close one of the refineries due to a low return on investment would significantly increase Hawaii's dependence on imported products, including gasoline, diesel, residuals, and jet fuel, directionally raise prices and require additional inventory for contingency supply.* ICF anticipates that both refiners will carefully review both these and the final PUC decisions to assess the potential impact on refinery financial performance.

ICF Report at pp. 74-75 (emphasis added). Given this position, ICF specifically acknowledges that the "implementation of the gas cap law as recommended in the Report could lead to an increased risk of a Hawaii refiner closing its Hawaii business[,]" which could result in a decrease in the available supply of gasoline in the state of Hawaii." *See* ICF's Response to SHELL-IR-76(a).

Despite its acknowledgment of this significant risk to supply, ICF admits that it "did not perform any analysis on the issue of the possibility of having to replace a refiner who closes it Hawaii operations because of the implementation of the gas cap law as recommended in the report." *See* ICF's Response to SHELL-IR-76(b). Further, when asked if it performed *any* analysis or research to study what effects the price cap implementation would have on the potential reduction of the available supply of gasoline within the State, ICF confirms that the only analysis it performed was to review relative gasoline margins that refiners would have for ANS, Bach Ho and Dur crudes based on an ICF import parity price. *See* ICF's Response to SHELL-IR-77. ICF "did not perform material calculations on other impacts[.]" *See* ICF's Response to SHELL-IR-77(b).

When asked whether it would be reasonable and prudent to perform research and analysis to study the effect of the implementation of the gas cap law (as recommended in the Report) on the available supply of gasoline within the State, ICF responds that:

> ICF believes that this issue could be studied for an extended period, in particular with upcoming ethanol legislation and lower US sulfur specifications. It is difficult for ICF to see how a calculative-based study will be credible due to the number of uncertainties in place. ICF believes a *more effective* approach would be to determine the most effective way to implement gas caps, or gas price *monitoring*, and ethanol streamlining in a logical and tactical manner to minimize disruptions and costs to consumers and Industry.

ICF's Response to SHELL-IR-77(b) (emphasis added). This response concedes that a "more effective" implementation method would be to consider all relevant factors – including sulfur differentials and ethanol streamlining – in designing the gas cap implementation: these are factors which were admittedly left out of the ICF Report. Moreover, ICF's recommendation that any such implementation be set forth in a "logical and tactical manner to minimize disruptions and costs to consumers and Industry[,]" recognizes that there are more "logical and tactical" methods to be developed than the present model. *See Id.*

Most telling, however, is ICF's flat refusal to confirm whether further analysis on this issue should be performed *prior to* the implementation of the gas cap law. *See Id.* In seeking to justify its position, ICF offered:

> ICF believes it is more reasonable and prudent to adopt a collaborative approach between Industry, the PUC, Legislature, and the Consumer Advocate to meet the intent of the Legislature in an optimal manner given the existing uncertainties.

ICF's Response to SHELL-IR-77(c). This response recognizes that there is a more "reasonable and prudent" "collaborative" approach to take than the present model. This response also demonstrates that "existing uncertainties[,]" require further study *prior to* price cap implementation. Ultimately, ICF's failure to deny that further study is necessary *prior to* implementation only serves to confirm that to do otherwise would be unreasonable and imprudent.

Given its responses, it is clear that ICF cannot even state with confidence that its recommended approach is supported by sound analysis and the data needed to properly understand the risk to supply should the price cap be implemented. What is extremely troubling is while ICF readily acknowledges the extreme relevance of this issue to its recommendations, ICF took no steps to address these effects in its study. This fatal omission, coupled with other significant errors in its analysis and assumptions used in its study – as set forth above - calls in to question the usefulness and relevance of the ICF Report. Shell believes that Hawaii consumers deserve a thorough understanding of the potential supply impacts before the legislation is implemented. Hawaii's consumers must not be subject to economic experimentation where the outcome is so uncertain.

B. Ethanol Blending Requirements in April 2006

Independent of the gas cap implementation, the ethanol blending legislation takes effect in April of 2006. This legislation states that "at least eighty-five per cent of all gasoline supplied to a retailer, sold at retail, or sold to a private, state, or municipal fleet for use in motor vehicles, and intended as a final product for fueling motor vehicles in the state of Hawaii, shall contain ten per cent ethanol by volume." Haw. Admin. R. § 15-35-3 (2004); *see also* Haw. Rev. Stat. § 486J-10.

The impacts of integrating the ethanol blending legislation, standing alone, are significant. It is undisputed that the petroleum industry is still attempting to understand the substantial impacts ethanol blending will have on existing operations. It is also undisputed that the petroleum industry is anxiously working to properly design and implement strategies to integrate this governmental mandate into their operations.

That the state government would choose to add even greater complexity and uncertainty to this landscape via the implementation of mandatory price caps is simply unfathomable.

Indeed, ICF correctly forecasts this "perfect storm" acknowledging that with ethanol blending set to be implemented in 9 months, "Hawaii is in a position where the timing of both mandates (the gas cap law and the ethanol) are creating *extraordinary and legitimate concern* among marketer and refiners." *See* ICF's Response to SHELL-IR-17(a) (emphasis added).

In its Report, ICF confirms that the yet-unknown impact of the ethanol legislation is relevant and material to any analysis concerning the gas cap implementation design:

> *The Hawaii gasoline market will change in 2006 as the ethanol legislation becomes effective in April 2006. The use of up to 10% ethanol in 85% of Hawaii's gasoline supply creates an immediate change in the State gasoline supply and demand from being about balanced to long. It will also likely result in higher costs for all suppliers to alter the distribution system to accommodate the ethanol blending and preserve gasoline quality integrity.*
>
> Since it is unlikely that the use of ethanol in Hawaii will impact either the Singapore or Caribbean markets, the Import Parity calculation will likely not be impacted. *Other changes however may be necessary to account for higher terminal and marketing costs.* Notwithstanding the formula changes, the fundamental supply and demand

> situation in Hawaii post-ethanol blending would tend to depress prices as suppliers work to rebalance and optimize their systems.
>
> The intent of this report was not to identify the issues or impacts of ethanol blending; however, it is clearly a factor which may need to be considered by the Commission in future Gas Cap management.

Report at p. 76 (emphasis added).

Despite its recognition of this relevant and material concern, ICF admits that neither the recommendations set forth in its Report or Haw. Rev. Stat. Chapter 486H address the impact of ethanol legislation. *See* ICF's Response to SHELL-IR-11; ICF's Response to SHELL-IR-12; ICF's Response to SHELL-IR-14; ICF's Response to SHELL-IR-15; ICF's Response to SHELL-IR-16; ICF's Response to SHELL-IR-17; ICF's Response to SHELL-IR-22; ICF's Response to SHELL-IR-54; ICF's Response to SHELL-IR-55; ICF's Response to SHELL-IR-74; ICF's Response to SHELL-IR-82. When asked why the ethanol impact was not studied, ICF states that "[t]he primary focus of the analysis was to address the Legislated factors and assumptions and determine if they were resulting in a competitive alternative price for Hawaii consumers. The future issues which may affect Hawaii were identified but not analyzed." ICF's Response to SHELL-IR-11(a).

This significant omission is yet another material flaw in this entire process. Again, the omission of material and relevant criteria undoubtedly calls into question the quality of ICF's entire analysis. The petroleum industry in this State does not exist in a vacuum. Shell seriously questions the relevance and usefulness of the existing legislation and ICF's recommendations because neither one takes into consideration the ethanol impact.

Moreover, this fundamental flaw in the analysis proposed by ICF cuts even deeper, because ICF's recommendations are only temporary, and will admittedly become obsolete inside of 9 months.

ICF concedes by admission that the ethanol legislation will impact its observations, findings, and recommendations to its proposed import parity calculation. ICF "*does not know how the import party price calculation will be performed in 2006 after the Ethanol blending law is implemented.*" *See* ICF's Response to SHELL-IR-16; ICF's Response to SHELL-IR 12 (emphasis added). Consequently, ICF "believe[s] that once the Hawaii Ethanol legislation is implemented in 2006, *it would be appropriate for the recommended formula and process* for computing gas caps, and for monitoring same, as set forth in § 7.0 of the Report, [sic] *be adjusted to reflect the impact of the Ethanol legislation.*" *See* ICF's Response to SHELL-IR-74 (emphasis added). In other words, ICF admits that within a year, the price cap formula and monitoring process that it has recommended will have to be changed to account for the ethanol impact.

As we sit here today, *ICF admittedly does not know how the price cap formula will be computed after the Ethanol blending law is implemented.* Further, insofar as the existing legislation does not take into account the ethanol impact, that legislation is deficient and will have to be changed.

In recognition of the significant limitations and usefulness of its proposed analysis which is due, in part, to its failure to address the ethanol impact, *ICF now recommends against full implementation of the price cap law*:

> [Question] In addition, ICF raised concerns in the Report about both the Ethanol mandate and the Small marketers (related to remote locations). The sessions in May, and the

> Parties' questions to ICF in both matters confirm that these are issues which should be addressed. ICF concurs that the Ethanol mandate will create a need to modify the Gas Cap structure, and the small marketer impact will occur immediately (September 1 and later).
>
> [Response] *ICF believes the scope of the Ethanol issue, and the time to fully understand the impact on Ethanol cost, supply and storage is a basis to recommend to the PUC that the Gas Cap implementation be initiated on a "calculation and monitoring" basis until the Ethanol mandate is in place and functional.* This also provides more time to understand the small marketer impacts.

ICF's Response to CA-IR-1 (emphasis added). That the PUC's own expert, tasked to design a strategy for implementation, cannot recommend full price cap implementation is extremely significant and cannot be ignored.

Accordingly, while Shell does not believe that the gas cap law should be implemented in any form, it agrees with ICF that any design and implementation of a gas cap must take into consideration the material impacts that flow from the implementation of the ethanol legislation.

C. Impact to Neighbor Islands and Remote Areas

1. The Mandatory Legislative Task Force

SB No. 3193, passed final reading as amended in C.D.1 and Act 242 became law on July 14, 2004 without the Governor's signature. Section 12 of Act 242 states that "[t]his Act shall take effect on July 1, 2004." SB No. 3193, C.D. 1 (2004). There have been no subsequent amendments to Act 242. *Act 242 is currently the law of the land.*

In passing the 2004 amendments, the Legislature specifically noted that "to ensure that the market conditions and attributes of the neighbor island markets are confronted and properly addressed, it is appropriate that further study be undertaken by the legislature through a legislative task force." 2004 Haw. Sess. Laws, Act 242, § 1.

In furtherance of this concern, the Legislature passed Section 7 of Act 242 requiring the formation of this task force to be made up of members of the legislature from the neighbor islands, and the Directors of the Departments of Business, Economic Development & Tourism and the Department of Transportation:

> SECTION 7. (a) *There shall be convened a special task force comprised of eight members of the legislature representing districts on the islands of Kauai, Maui, Molokai, Lanai, and Hawaii to investigate the petroleum industry and is operations and impacts on the islands of Kauai, Maui, Molokai, Lanai, and Hawaii.* The director of business, economic development, and tourism and the director of transportation or their respective representatives shall serve as ex officio members of the task force.
>
> (b) Four members of the task force shall be appointed by the speaker of the house of representatives and four members shall be appointed by the president of the senate. Of the eight members, the speaker of the house of representatives and the president of the senate shall each select a co-chairperson for the task force.

2004 Haw. Sess. Laws, Act 242, § 7 (emphasis added).

The duties of this legislative task force were spelled out in great detail, targeted at understanding the neighbor-island markets, in order to provide the Legislature with all relevant information needed to determine the impacts of the price cap legislation on our unique neighbor-island markets:

> (c) *The duties of the task force are as follows:*
>
> (1) *obtain an inventory of petroleum facilities serving each of the islands of Kauai, Maui, Molokai, Lanai, and Hawaii*, including, but not limited to, ships, barges, and other modes of transporting, loading and off-loading facilities, storage facilities, and pipelines and rolling stock for the movement and distribution of petroleum products;

> (2) *Meet with persons involved in the petroleum industry on the islands of Kauai, Maui, Molokai, Lanai, and Hawaii, including, but not limited to, shippers, wholesalers, jobbers, retailers, and consumers*;
>
> (3) *Determine the special needs and concerns of the petroleum suppliers and consumers on the islands of Kauai, Maui, Molokai, Lanai, and Hawaii*;
>
> (4) *Determine what, if any, special barriers to competition exist on the islands of Kauai, Maui, Molokai, Lanai, and Hawaii*;
>
> (5) Review the need for a tax credit program to encourage the development of additional fuel storage terminal facilities on the islands Kauai, Maui, Molokai, Lanai, and Hawaii;
>
> (6) *Consider the need for a Hawaii fuel authority that would own and operate a fuel import terminal, buy gasoline in the world market, and resell the gasoline at retail at cost throughout the State*;
>
> (7) *Determine the appropriateness of the delineation of the various zones and the zone price adjustments*; and
>
> (8) *Consider any other issues or concerns that it may have relating to the petroleum industry in the State.*

Id. (emphasis added).

Most importantly, this law required that the legislative task force prepare and submit a written report of the findings of their investigation, together with any recommendations, and/or proposed alternative legislation, to the Legislature *before the start of the 2005 legislative session* in January 2005:

> (e) *The task force shall prepare and submit a report with recommendations, including any proposed legislation, to the legislature twenty days before the convening of the regular session of 2005.*

Id. (emphasis added). In other words, Section 7 of the Act 242 specifically contemplated that the 2005 Legislature would have the benefit of: (1) the task force's understanding of the gas cap implementation's impacts on the neighbor islands and remote areas and (2) the task force's recommendations and proposed legislation to address these impacts. The timing of this report as required under the law, was intended to give the Legislature and the PUC the benefit of this analysis prior to any implementation of the law so they could amend the law and take other appropriate action.

This is evident in the 2004 Legislature's reasons for including Section 7 as a requirement under the law:

> *The legislature also recognizes that Hawaii, being a chain of islands with different demographics, populations, terminal and storage facilities, and economies of scale, contains different sub-markets and that it is necessary to identify these sub-markets by zones.* Accordingly, the public utilities commission should have the authority to make any necessary adjustments to the maximum pre-tax wholesale gasoline prices in recognition of any unique attributes of these sub-markets that may have an impact on the prices. *As a check on the zone price adjustments, however, and to ensure that the market conditions and attributes of the neighbor island markets are confronted and properly addressed, it is appropriate that further study be undertaken by the legislature through a legislative task force.*

SB No. 3193, C.D. 1. (2004) (emphasis added). Indeed, in *a prior version* of SB 3193 (H.D. 1), the Legislature specifically acknowledged its understanding and appreciation of the unique problems facing the smaller markets on the outer islands:

> The legislature further recognizes that the more remote gasoline retail markets on the islands of Kauai, Maui, and Hawaii are serviced by relatively small and middle sized jobbers. *These jobbers lack the economies of scale that the*

> *refiners, non-refiners, and large jobbers enjoy. Accordingly, the legislature finds it appropriate that jobbers that service the smaller markets on Kauai, Maui, and Hawaii be given an added neighbor island wholesale adjustment factor.*
>
> * * * *
>
> *The legislature also believes that consumers and retail gasoline dealers on the neighbor islands are especially in need of assistance, due to the added transportation costs and lack of adequate terminals for the off loading and storage of gasoline on the neighbor islands. To further ensure that the special conditions and concerns with which residents on the neighbor islands are confronted are properly addressed, further study is necessary.*
> The purposes of this Act are to:
>
> * * * *
>
> *(8) Establish a legislative task force to investigate the petroleum industry and its operations on the islands of Kauai, Maui, Molokai, Lanai, and Hawaii*[.]

SB 3193 (H.D. 1) (2004) (emphasis added).

In addition, the legislative history contained in the various committee reports supporting the 2004 amendments to the law provides insight for the creation of this requirement. The House Standing Committee Report No. 1184-04 (2004) observes that:

> The Department of Business, Economic Development, and Tourism, Chamber of Commerce of Hawaii, Western States Petroleum Association, Tesoro Hawaii Corporation, Aloha Petroleum, Diamond Head Petroleum, Inc., Maui Petroleum, Inc., Hawaii Petroleum, Inc., Garlow Petroleum, Inc., Kahala Shell Auto Care, Inc., West 1 Properties LLC, Hawaii Island Portuguese Chamber of Commerce, Duke's Management Corporation, Kawamata Brothers, Ltd., Sure Save Super Market, Ltd., *and numerous petroleum retailers, jobbers, and concerned individuals testified in opposition to this measure.*

House Standing Committee Report No. 1184-04 (2004) (emphasis added); *see also* Senate Standing Committee Report No. 2429 (2004) (indicating similar opposition testimony received by the Senate Standing Committee).

In response to this testimony, Senate Standing Committee Report No. 2429 (2004) provides that:

> Your Committee is mindful of the concerns raised in response to this measure and is especially cognizant of the concerns raised by some retail dealers, including several Neighbor Island retail dealers. *Your Committee will attempt to address these concerns as the measure is further considered.*

Senate Standing Committee Report No. 2429 (2004) (emphasis added).

It is readily apparent that the legislative task force was added to Act 242 in order to "address these concerns" and conditions facing the petroleum industry on the outer islands including the concerns raised by the "numerous petroleum retailers, jobbers and concerned individuals" who testified against the bill. In fact, Senate Conference Committee Report No. 158-04 provides that:

> Your Committee finds that the petroleum industry and its operations on the islands of Kauai, Maui, Molokai, Lanai, and Hawaii differ from its operations on Oahu, *thereby warranting a special legislative task force to study the petroleum industry, its infrastructure, facilities, and operations on the Neighbor Islands and the resultant impact on gasoline consumers on those islands.*

Senate Conference Committee Report No. 158-04 (2004) (emphasis added); *see also* Senate Standing Committee Report No. 2860 (2004) ("Your Committee further finds that small and mid-sized jobbers serving the smaller and more remote retail markets on the Neighbor Islands lack the economies of scale that the refiners and larger jobbers enjoy").

a. The Legislative Task Force Report Required Under Section 7 of Act 242 Is Pre-Condition To Any Implementation Of Haw. Rev. Stat. Chapter 486H That Cannot Be Ignored

(i) Hawaii Law Governs The Interpretation Of Act 242

The task force requirements are contained in Act 242 but are not part of the Haw. Rev. Stat. Chapter 486H. *Nevertheless, an Act is a statutory "law" enacted by the legislature.* *See* Haw. Rev. Stat. § 1-12; *see also In re Marques*, 37 Haw. 260 (Haw. 1945) ("[a]n *Act of the legislature becomes a law* upon its approval by the governor unless its operation is postponed by its own terms.") (emphasis added); *Black's Law Dictionary*, at 25 (6th ed. 1990) (legislative *Act is alternative name for statutory law* and once enacted the terms *"law" and "act" are interchangeable*) (emphasis added).

In interpreting an Act, the rules regarding statutory interpretation and construction apply. In fact, Haw. Rev. Stat. § 1-12 provides that:

> All provisions of the Hawaii Revised Statutes relating to general statutory construction shall apply not merely to *laws* now in force but *to all hereafter enacted*, unless otherwise expressed or obviously intended.

Haw. Rev. Stat. § 1-12 (emphasis added).

The "foremost obligation" in interpreting statutes is to *ascertain and give effect to the intention of the legislature*, obtained primarily from the plain language contained in the statute itself. *See State v. Dudoit*, 90 Hawaii 262, 978 P.2d 700 (Haw. 1999). In *Keliipuleole v. Wilson*, 85 Haw. 217, 941 P.2d 300 (1997), the Supreme Court of Hawaii summarized the applicable rules of statutory construction as follows:

> When construing a statute, the starting point is the language of the statute itself. Courts are bound to give effect to all parts of a statute, and that no clause, sentence, or word shall be construed as superfluous, void, or insignificant if a construction can be legitimately found which will give force to and preserve all words of the statute. *Words are*

> *given their common meaning unless some wording in the statute requires a different interpretation.*
>
> Moreover, although the intention of the legislature is to be obtained primarily from the language of the statute itself, we have rejected an approach to statutory construction which limits us to the words of a statute, for when aid to construction of the meaning of words, as used in the statute, is available, there certainly can be no rule of law which forbids its use, however clear the words may appear on superficial examination. Thus, *the plain language rule of statutory construction does not preclude an examination of sources other than the language of the statute itself even when the language appears clear upon perfunctory review.* Were this not the case, a court may be unable to adequately discern the underlying policy which the legislature seeks to promulgate and, thus, would be unable to determine if a literal construction would produce an absurd or unjust result, inconsistent with the policies of the statute.
>
> Finally, *a rational, sensible and practicable interpretation of a statute is preferred to one which is unreasonable or impracticable, because the legislature is presumed not to intend an absurd result, and legislation will be construed to avoid, if possible, inconsistency, contradiction, and illogicality.*

Id. at 221-22, 941 P.2d at 304-05 (citations omitted) (emphasis added). Consistent with Hawaii case law, Haw. Rev. Stat. § 1-14 provides:

> The words of a law are generally to be understood in their most known and usual signification, without attending so much to the literal and strictly grammatical construction of the words as to their general or popular use or meaning.

Haw. Rev. Stat. § 1-14.

In interpreting the word "shall", the term as used in "a statute is directory rather than mandatory if the provisions of the statute do not relate to the essence of the thing to be done or *where no substantial rights depend on compliance with the particular provisions and no injury can result from ignoring them.*" *State v. Toyomura*, 80 Hawaii

8, 20, 904 P.2d 893, 904 (1995) (emphasis added). For example, in *Coon v. City and County of Honolulu*, 98 Hawaii 233, 47 P.3d 348 (Haw. 2002), the Hawaii Supreme Court held that the use of the word "shall" in the time requirement for Revised Ordinance of Hawaii ("ROH") § 38-5.2 was mandatory and not directory. (ROH § 38-5.2 stated that: "[w]ithin 12 months after the designation of the development or portion thereof for acquisition, the department *shall* facilitate the acquisition of the leased fee interest in the land ... or the institution of eminent domain proceedings."). The Court reasoned that:

> *Construing the word "shall" as mandatory in the present context is consistent with the "the entire act, its nature, its object, and the consequences that would result from construing it" otherwise. Himuro*, 70 Haw. at 105, 761 P.2d at 1149. First, the Department's designation under ROH § 38-5.2 is predicated on the submission of the requisite number of applications prescribed by the ordinance as the threshold for triggering conversion proceedings. It is intuitively obvious that the designation's significance and reliability diminish with time; the applicants upon whom designation is based may move, decease, or otherwise become ineligible for lease-to-fee conversion pursuant to ROH ch. 38. Second, *interpreting the deadline as directory rather than mandatory could adversely affect the private parties involved.* If the time provision were merely directory, the Department could designate a project for conversion and defer the institution of condemnation proceedings indefinitely. [FN42] The resulting delays would hold lessors hostage to the openended threat of condemnation and leave lessees seeking to acquire their leased fee interests in a state of limbo, not knowing whether to wait for the City to proceed or to look elsewhere. *The adverse impact upon the private parties to ROH ch. 38 proceedings weigh in favor of interpreting the word "shall," as set forth in the time provision of ROH § 38-5.2, as mandatory rather than directory . . . .*

Coon, 98 Hawaii at 258, 47 P.3d at 372 (emphasis added) (footnotes omitted).

(ii) The Legislative Task Force Requirements of Act 242 are Mandatory

The language of the statute is unambiguous and clear that both the convening of a legislative task force and the fulfillment of the task force's duties are mandatory and required under Act 242.

The word "shall" is used several times in Act 242 Section 7's requirement for the legislative task force:

> *There shall be convened* a special task force comprised of eight members of the legislature representing districts on the islands of Kauai, Maui, Molokai, Lanai, and Hawaii to investigate the petroleum industry and its operations and impacts on the islands of Kauai, Maui, Molokai, Lanai, and Hawaii.
>
> * * * *
>
> (b) Four members of the task force *shall* be appointed by the speaker of the house of representatives and four members shall be appointed by the president of the senate. Of the eight members, the speaker of the house of representatives and the president of the senate *shall* each select a co-chairperson for the task force.
>
> * * * *
>
> (e) The task force *shall* prepare and submit a report with recommendations, including any proposed legislation, to the legislature twenty days before the convening of the regular session of 2005.

SB No. 3193, C.D. 1 (2004) (emphasis added).

As used in Act 242, Section 7, the word "shall" (especially with regard to the convening of the task force and the deadline for the report to the legislature) is mandatory and not directory because interpreting it otherwise "could adversely affect" the public and private individuals. *See Coon*, 98 Hawaii at 258, 47 P.3d at 372. This adverse affect is recognized by the legislature *in the Act itself*:

> As a check on the zone price adjustments, however, and *to ensure that the market conditions and attributes of the*

> *neighbor island markets are confronted and properly addressed*, it is appropriate that further study be undertaken by the legislature through a legislative task force.

SB No. 3193, C.D. 1. (2004) (emphasis added).

Moreover, the legislative history surrounding the 2004 amendments, as set forth above, is unmistakably clear that there are anticipated adverse effects on retailers, jobbers, and individuals in neighbor island markets if the effect of the gasoline price cap on the neighbor island markets is not studied and addressed by the legislative task force. *See* Senate Standing Committee Report No. 2429 (2004); House Standing Committee Report No. 1184-04 (2004); Senate Standing Committee Report No. 2429 (2004); Senate Conference Committee Report No. 158-04.

The word "shall" as used in Act 242, Section 7 is also mandatory because of due process considerations that result from the failure of the legislative task force to convene and carry out its duties. Among other things, the legislative task force is required to:

> (2) Meet with persons involved in the petroleum industry on the islands of Kauai, Maui, Molokai, Lanai, and Hawaii, including, but not limited to, shippers, wholesalers, jobbers, retailers, and consumers;
>
> (3) Determine the special needs and concerns of the petroleum suppliers and consumers on the islands of Kauai, Maui, Molokai, Lanai, and Hawaii;
>
> * * * *
>
> (7) Determine the appropriateness of the delineation of the various zones and the zone price adjustments; . . . .

SB No. 3193, C.D. 1. (2004). The failure of the legislative task force to convene and meet with the persons "involved in the petroleum industry on the islands of Kauai, Maui, Molokai, Lanai, and Hawaii, including, but not limited to, shippers, wholesalers, jobbers, retailers, and consumers" violates those affected persons due process rights. Under Act 242, these people are entitled to be heard by this legislative task force composed of their representatives in the legislature before Haw. Rev. Stat. Chapter 486H is implemented (and adversely affects them). Thus, their due process rights make the convening of the legislative task force mandatory. *See e.g. Perry v. Planning Commission of Hawaii County*, 62 Haw. 666, 619 P.2d 95 (Haw. 1980) ("Notice and hearing requirements are within the foregoing category because of obvious due process considerations") (citation omitted).

b. <u>The Legislative Task Force Was Never Formed And The Required Report Never Done</u>

Remarkably, in violation of this clear and unambiguous mandatory law, none of the requirements of Section 7 were ever completed. No task force was ever formed. No investigation was ever done. No report was ever prepared or submitted to the legislature. The concerns of the 2004 Legislature which prompted the formation of this very important piece of legislation to fully study and ascertain the potential impacts on the neighbor islands, were simply ignored.

Moreover, no explanation has ever been given for this blatant omission. The ICF Report does not even mention or account for the missing procedure and report. Also, there was no mention of the failure to comply with the law during the legislative briefing process carried out in this docket. The legislature's inexplicable violation of the law cannot be ignored. If the gas price cap is to be implemented as scheduled, immediate action must be taken to address the serious and compelling problems resulting from the legislature's unprecedented neglect.

c. <u>The Legislative Task Force Must Be Convened And Fulfill Its Purpose Prior To Implementation Of The Gasoline Price Caps</u>

While Act 242 does not specifically say that the price cap cannot be implemented until the legislative task force is convened and fulfills its duties, such a requirement is the only "rational, sensible and practicable interpretation" interpretation of Act 242.

It makes absolutely no sense to require a mandatory legislative task force to address the concerns and needs of the neighbor islands and issue a report to the legislature *after* the gasoline price cap is implemented. In fact, that is precisely why the task force was required to issue its report "prepare and submit a report with recommendations, including any proposed legislation, to the legislature twenty days before the convening of the regular session of 2005" so that the adverse effects of the gasoline price cap could be addressed by the Legislature prior to its implementation on September 1, 2005.

Therefore, Act 242 must be read so that the price cap cannot be implemented until the legislative task force is convened and fulfills its duties. This conclusion is consistent with the legislative prescription to avoid constructions that lead to absurd results. *See Yoshizaki v. Hilo Hosp. Ex Rel. Managing Comm.*, 50 Haw. 150, 433 P.2d 220 (S. Ct. 1967); Haw. Rev. Stat. § 1-15 ("Every construction which leads to an absurdity shall be rejected"); *Levy v. Kimbal*, 51 Haw. 540, 545, 465 P.2d 580, 583 (1970) ("In the construction of a statute the general law is that a statute should be so interpreted to give it effect; and we must start with the presumption that our legislature intended to enact an effective law, and it is not to be presumed that legislation is in vain effort, or a nullity").

Moreover, reading Act 242 so that the price cap cannot be implemented until the legislative task force is convened and fulfills its duties is in accord with "*the reason and* *spirit of the law, and the cause which induced the legislature to enact it*[.]" *State v. Pesentheiner*, 95 Haw. 290, 293-294, 22 P.3d 86, 89-90 (quoting *Amantiad v. Odum*, 90 Haw. 152, 160-61, 977 P.2d 160, 168-69 (1999)); Haw. Rev. Stat. § 1-15 ("The reason and spirit of the law, and the cause which induced the legislature to enact it, may be considered to discover its true meaning.").

Under Act 242, Section 7, the legislative task force was supposed to provide its report and recommendations to the legislature before the 2005 regular session so that the legislature could address the concerns of retailers, jobbers, and individuals in neighbor island markets before the implementation of the gasoline price cap on September 1, 2005. Moreover, the legislative task force was to propose alternative legislation to amend Haw. Rev. Stat. Chapter 486H to address these concerns. Therefore, the "reason and spirit" of Act 242, Section 7 can only be to allow the legislature to address possible adverse effects of the gasoline price cap on the neighbor island markets *before* its implementation.

It should also be noted that the PUC is charged with implementing the gasoline price cap and has the responsibility to: (1) collect information from manufacturers, wholesalers, and jobbers; (2) determine and publish the maximum prices including the base line prices and adjustment factors including zone price adjustments; (3) determine the extent of compliance by manufacturers, wholesalers, and jobbers; and (4) report to the governor and the legislator significant aberrations, trends or conditions that may adversely impact gasoline consumers. *See* Haw. Rev. Stat. § 486H-13. In addition, "[t]he commission shall adopt rules pursuant to chapter 91 as may be necessary to implement this section and section 486H-16." Haw. Rev. Stat. § 486H-13(o). Thus, as the agency administering HRS § 486H/Act 242, the PUC's interpretation and application is accorded substantial deference.

Given Act 242's language *requiring* the legislative task force to address the concerns regarding the impact of the gasoline price cap law on the neighbor islands, *it is entirely appropriate and reasonable for the PUC to interpret Act 242 to require that the legislative Task Force be convened and perform its duties prior to the PUC's implementation of the gasoline price caps.* Again, such interpretation is only logical and consistent with the letter and intent of Act 242.

2. The Present Investigative Docket

The inexplicable failure to comply with the clear, mandatory, and substantial requirements of the law simply underscores that this process is extremely premature. While the PUC, through its administration of the present docket, has made a remarkable attempt to mitigate the harm caused by the Legislature's failures, the PUC in not able to cure these failures.

When reviewing the events and record of this investigative docket with the knowledge that a legislative task force was supposed to have convened and recommended a fix, *it is obvious that the very same unanswered questions that have been raised in this proceeding and exist today, should have been addressed by the task force report and the 2005 Legislature.*[4] Sadly, the record also makes it clear that while the 2004 Legislature had the foresight to anticipate these problems, it did not have the resolve to follow-through to ensure that its legislative intent be fulfilled. That there is even momentum to

[4] Insofar as Section 7 of Act 242 specifically required that the legislative task force report include "recommendations, including any proposed legislation" to address these impacts and concerns of the neighbor islands.

still implement this flawed law calls into question the motivations of those seeking to push the law through. Regardless, Shell respectfully asks that the PUC set aside any agenda other than to make a determination and recommendation in this docket, based upon the clear record established in this case.

a. ICF Has Chosen To Ignore The Impact Of The Gasoline Price Caps To The Supply Of Gasoline In The Remote Areas Of The Neighbor Islands

The ICF Report specifically acknowledges that:

> *There may be some unique situations (similar to Hana on Maui) in which small jobbers or distributors have few outlets which are in a high-cost-to-deliver regions, and the PUC may wish to consider some exceptions or further adjustments.* Overall, the Gas Caps are structured so that sales at or approaching a DTW cap should provide a margin to cover a purchase at wholesale rack prices plus delivery cost, and profit. As with the Refining sector, wholesale marketing suppliers will likely have to closely examine business costs and margins in a market that is regulated. *Since the total number of suppliers in Hawaii is small to begin with, the attrition of any marketers due to the Gas Cap impact needs to be quickly understood to minimize supply issues to consumers.*

Report at p. 75 (emphasis added). Thus, ICF acknowledges that the implementation of the gas cap law as recommended in the Report could lead to an increased risk of gasoline marketers and/or suppliers deciding to cease operations in remote areas on the neighbor islands.

Unfortunately, ICF has not addressed this risk. *See* ICF's Response to Shell-IR-78. ICF admits that it would be "reasonable and prudent" for an analysis to be fully performed so as to understand these impacts, *prior to the implementation of the price cap law*. *See Id.* Once again, ICF has chosen to ignore material impacts on supply: ICF did not perform any analysis or research to study what the effect of the price cap implementation would have on the marketers and/or suppliers in remote areas on the neighbor islands. *Id.*

b. The PUC's Attempt To Compensate For The Legislature's Failure To Properly Examine The Risks To The Neighbor Islands Merely Confirms The 2004 Legislature's Concern Regarding The Significant Risks to Neighbor Island Supply And The Failure Of The Present Proposal To Properly Address Those Risks

In this investigative docket, the PUC has sought to make up for the Legislature's deficiency by holding public hearings across the State in the 8 zones designated in Haw. Rev. Stat. § 486H-13(h). These hearings have only confirmed what ICF feared would be true – *that there is significant, legitimate concern on marketers, suppliers, and consumers on the neighbor islands about the disproportionate impact that the gas cap will have on their operations.*

On Kauai, there was testimony from Roger Cable of Senter Petroleum (a Chevron jobber):

> *As the law* was -- *is currently on the books, there is no margin there for the jobber trade.* We are a very necessary part of the distribution system, and we take care of a very important segment of the industry.
>
> *There was no consideration given to outer island deliveries for independent service stations. The reason you didn't get much response on Oahu is because there are no jobber service stations on the island of Oahu. There are on the outer islands, and it's important for us to be able to serve these stations because they're not – they would not be served by the major oil companies.* This has been seen throughout the state that the major oil companies are focusing on stations that produce a significant quantity of volume, and the little mom and pop stations are gone.

May 3, 2005 Kauai Hearing, at 21-22 (emphasis added). Senter Petroleum emphasized that the ICF Report does not properly address Hawaii jobbers because it does not use any realistic comparisons:

> *The ICF report addresses the jobber-level service but does not use realistic market comparisons.* We're a very small market here [Kauai]. 60,000 people. And our volume throughout the island is probably not as big as some of the service stations that are being served by the jobbers on the mainland. They have fleets of trucks [on the mainland]. They move millions of gallons of gasoline. And they have an assortment of racks that they can go to -- for the independent service stations. They can go to the one that has the lowest price that day and pick up their gasoline and take it to a service station.
>
> This is a totally different market. We have a very small market, and it's a very restricted market. And our costs, of course, are much higher. *The figures that were used to create the margins in the ICF report are absolutely ridiculous. If you look at the report, in a sense, they use one standard margin across the board for the entire state. That doesn't work.* For us, we take a severe penalty on the island of Kauai using the ICF figures. Whereas, on Oahu, they would get a larger margin.
>
> *Obviously, there's something wrong with that calculation, and it needs to be looked at very closely before you would implement something that would cause severe harm.*

Id. at 22-24 (emphasis added). Senter Petroleum also explained that:

> *Costs for providing services on Kauai are much higher than the mainland and markets used in the ICF report. And not only are the markets the wrong size, it's a different type of business. We have smaller trucks.* We deliver 4,500 gallons at a time. We aren't using triple trailers that carry 27,000 gallons or 18,000 gallons of fuel between points over super highways. We're coming in off the rack and we're going out to the independent service stations delivering fuel.

> It's important that you look at all of these figures. It's -- and that you implement fair margins to allow the outer islands' jobbers and independent service stations to survive in the marketplace.

Id. at 24 (emphasis added). Accordingly Senter Petroleum advised the PUC that under the ICF Report, "the independent stations are not being treated fairly in comparison to supplier-direct stations." *Id.* at 24. It further reasoned that the various adjustment factors/margins: "just kind of bypasses everything and goes direct out of the tanks to the stations" which it believes "can't be done with the independent stations or through the jobbers." *Id.*

Testimony on Kauai was also taken from an independent service station owner in Princeville (Mr. Jeff Guest) who is a jobber-served dealer serviced by Senter Petroleum. Mr. Guest testified that the gas cap is "going to affect the jobbers considerably[,]" stating that: "if I were in Senter Petroleum's shoes, I would stop delivering fuel to us." *Id.* at 25. Mr. Guest explained that if Senter Petroleum stops delivering fuel:

> basically, I've got to go out and see if Chevron will deliver to us directly. Basically, Chevron stopped almost ten years ago delivering fuel to us, and Senter Petroleum stepped in and said, hey, we'll take care of you, you're a small-volume dealer, we'll get gasoline out to you. This law doesn't address any of that.

Id. at 25. Mr. Guest also expressed his concern that:

> from September 1st, we're going to be looking at a situation where, okay, how are we going to get gas out to our station if the jobber can't supply it. If I were a jobber, I would say -- I don't think they're obligated to do it. I would stick to my wholesale accounts where I can have a fair market return on my product, you know.

> They're going to have to go out there and get gas out to me for 4 cents a gallon. You know, it's just -- there's not enough money in there to deliver fuel out to the North Shore. *And we're being compared to a station in Lihue, which is 40 miles different -- or not 40 miles. It's about a 40 to one-hour drive difference to -- you know, there's even zones within Kauai that are -- that need to be considered.*

Id. at 25 (emphasis added).

Finally, Mr. Guest also testified that: "*there should be some considerations to zones within zones. I don't see how, like I said, a Lihue station can be compared to Princeville or Waimea station. And I think that should be something that should be looked at.*" *Id.* at 27 (emphasis added). Mr. Guest stated his frustrations that:

> *Small mom and pop stations like mine may be out of business.* I've got 10 to 13 employees. Summertime, we'll have about 13 employees. Small business. Family owned. But, you know, there's other ways to make money on Kauai, I guess. But right now, I've been in the fuel business for 10 years and I've put a lot of money into my gas station, I'd like to see it survive.
>
> *The way I see this bill coming through, I'm going to be scrambling to survive. Economically, it doesn't seem feasible to me the way this bill is written to be a jobber-served gas station in a rural location and survive. It just doesn't seem feasible to me.* And I hope I'm wrong. I might have to -- I'll go down with a fight, that's for sure, you know. So we'll see what happens. . . .

Id. at 26-27 (emphasis added).

The testimony received from Kona was no less compelling. Mark Leong, vice president and general manager of Hawaii Petroleum and for Maui Petroleum on Maui, explained that:

> We [Hawaii Petroleum and Maui Petroleum] are a petroleum jobber here. We are not a refiner. We service -- we are one of twelve jobbers in the state of Hawaii. We service a lot of the small accounts out there. We service stations down in Kealakekua, service stations up mauka, up here. *We service stations, small stations, that can't take a whole truck-and-trailer load.* And the PUC's come up with recommendations on locations and a set delivery cost.
>
> *How can we -- what are we going to do? Are we going to tell the small stations that we're not getting paid enough to deliver gas to you? So you know what, we're not going to deliver gas to you today or tomorrow or next week. So we have a supply problem.* The refiners, you going to tell them how much they can make? They're going to say, you know what, you guys have tankers to ship out of state to another vicinity. What are we going to have? *We are going to have supply problems. It's supply and demand. The less supply you have, the higher the cost. I don't -- who's going to get hurt in the end? It's the consumer.* If the Gas Cap is implemented today as written, not recommended by the ICF, gas prices in Oahu would be nineteen to twenty percent higher than they are now. *Who knows what they would be on the outer islands. That is still to be decided based on zone pricing.*

See May 5, 2005 Kailua-Kona Hearing at 14-15 (emphasis added). According to Mr. Leong: "We're not big oil. You guys are going to hurt the small jobbers, the small retailers. They won't be able to take fuel because we can't deliver it. It's nuts. It just unbelievable." *Id.* at 16.

Compelling testimony was also received from the island of Maui. In Hana, there was the testimony of Alec McBarnet, who is the president of Maui Oil Company: Maui Oil Company is based in Kahului and services Hana and other remote areas of Maui. Mr. McBarnet noted that "when it comes time to look at . . . pricing, I don't know how one calculates some of those immeasurable types of things that occur in rural areas that cannot be without fuel under any circumstance in my opinion." "[T]here are some extraordinary circumstances that occur in rural areas that cannot be ignored . . . I think it's just very difficult for any body to come up at the moment to decide what those costs are in that manner." *See* May 9, 2005 Hana-Maui Hearing at 15.

Maui Oil Company also noted that:

> we have service stations up in Keokea on the way to Ulupalakua. *Harley and Florence Ching have operated that service station as a Chevron station for over 50 years, and they certainly are in a different zone within the zone than would be the zones if it was just in the Kahului area. I think Lahaina has to be considered another zone also because it's a different kind of delivery load and certainly Hanzawa's and Toma's up in Haiku are certainly kind of a delivery zone area also.*
>
> *I just -- I don't think it's fair to attempt to say that their deliveries would be the same as the deliveries within the Kahului area. . . . on Maui just like Kauai and the Big Island we have places that are in the zone that need zones within the zone.*
>
> Also in these areas again, if indeed if the law is implemented strictly as it was written at the end prior to the ICF's recommendations and we are not given any opportunity to add any pennies to the delivery for delivery purposes, *we're going to find ourselves not being able to deliver to the rural areas.* My understanding the law as it originally came out of the Legislature, whatever it was at pickup is what needs to be charged at delivery.
>
> ICF, of course, makes some room for that, but the law itself is pretty clear if I buy it for a dollar, I have to deliver it for a dollar at the purity of the law, my understanding. If that is not adjusted, then there just aren't going to be some deliveries done, because we cannot ask our drivers not to be paid. We can't ask our insurance companies not to charge us for that premium for those deliveries. We can't ask the bankers we have mortgages for on the trucks not to do that. *So I'm very concerned about again how it continues down the path and how it works out.*

Id. at 16-18 (emphasis added).

Testimony from Hanzawa's Store located in Haiku, Maui - an independent service station selling gasoline for over 50 years - also reiterated these concerns, noting that:

> We are not faced with this impending wholesale gas price cap that although aimed at refiners, will inevitably affect all members and levels I this industry. *Our concerns focus specifically on the possibility that our distributors may decide not to deliver gas supplies to rural areas like ours if they are held to a small margin that may not cover their expenses. Since we have no means to pick up gasoline ourselves, we will be forced to close our gas station.* This will not only hurt our business and chance to recoup some of the funds spent on our renovation, but also all of the area residents who depend on us for their gas as they rush off to work or school.
>
> Let me tell you that I've lost sleep over this as I'm concerned for the future of my business. We are all aware that this is a very complex issue with many variables to examine. While there are no easy answers, this gas cap may have serious consequences for small businesses like ours. Please don't let this be our demise.

Letter dated May 10, 2005 from Sally Daniells of Hanzawa's Store to the PUC.

c. <u>The PUC Does Not Presently Have The Ability to Amend The Law To Address These Neighbor Island Concerns</u>

The compelling testimony set forth above and taken in the meetings across the State have been given by "persons involved in the petroleum industry on the islands of Kauai, Maui, Molokai, Lanai, and Hawaii, [and] include[] . . . shippers, wholesales, jobbers, retailers, and consumers[,] and have helped to identify "the special needs and concerns of the petroleum suppliers and consumers on the islands of Kauai, Maui, Molokai, Lanai, and Hawaii[.]" *See* Act 242 § 7. The process has definitely helped to "[d]etermine the appropriateness of the delineation of the various zones and the zone price adjustments[.]" *Id.*

Indeed, these meetings confirmed that the concerns and predictions of the 2004 Legislature and ICF Report are true, and that there are in-fact a significant, legitimate concerns of a disproportionate adverse impact to neighbor islands, and in particular, remote areas in the neighbor islands. However, while the PUC has made an extraordinary effort to make up for the legislature's shortcomings, *it cannot cure the legislature's fatal error in failing to produce the task force report for full consideration by the 2005 legislature.*

For example, the PUC cannot address the concerns of the neighbor islands by altering the mandated zones. Unlike subparagraphs (c) - (g) of Haw. Rev. Stat. § 486H-13 which authorizes the Commission to modify and propose alternatives to the law as currently drafted, Haw. Rev. Stat. §§ 486H-13(h) (which mandates 8 different petroleum zones) does not authorize the PUC to modify the statute, or to add a zone within a zone. Therefore, the PUC does not have the ability to propose that additional zones be designated. *See Stop H-3 Ass'n v. State Dept. of Transp.*, 68 Haw. 154, 706 P.2d 446 (Haw. 1985) ("A public administrative agency possesses only such rule-making authority as is delegated to it by the state legislature and may only exercise this power within the framework of the statute under which it is conferred). Furthermore, as a practical matter, the PUC currently does not have sufficient information to even make a determination of what additional zones should be designated. Ironically, as set forth above, the legislative task force was specifically tasked to "[d]etermine the appropriateness of the delineation of the various zones and the zone price adjustments" so that the 2005 Legislature could take appropriate action. See 2004 Session, Act 242, § 7.

Another example is on the issue of whether the potential loss of supply to the neighbor islands would require the need for the State to take steps to encourage the development of additional fuel facilities to the neighbor islands. As set forth above, the task force was required *inter alia.* to "[r]eview the need for a tax credit program to encourage the development of additional fuel storage terminal facilities on the islands of Kauai, Maui, Molokai, Lanai, and Hawaii;" and "[c]onsider the need for a Hawaii fuel authority that would own and operate a fuel import terminal, buy gasoline in the world market, and resell the gasoline at retail at cost throughout the State[.]" 2004 Session, Act 242, § 7. Haw. Rev. Stat. Chapter 486H, as currently drafted, does not expressly authorize the PUC to recommend the implementation of these measures. As such, *the PUC does not have the ability, in the present proceeding, to propose this course of action.* Nor does there appear to be sufficient information to make an appropriate determination of what types of tax credits or fuel authority is required, other than to say that the record of this case warrants immediate, further examination on these issues.

While it was unnecessary for the 2004 legislature to afford the PUC this discretion given the anticipated task force report and anticipated opportunity during the 2005 session to enact alternative legislation to address the problems identified by the task force, it was certainly not foreseeable that those responsible for carrying this mandate would shirk their duties and create the present situation.

Compounding the problem is the dearth of procedures or protocol to address gasoline shortages in these remote areas. ICF concedes that it did not perform any analysis on the issue of the possibility of having to replace marketers or suppliers who choose to cease operations in remote rural areas on the neighbor island because of the implementation of the gas cap law as recommended in the Report. *See* ICF's Response to SHELL-IR-78(c). Similarly, the PUC has acknowledged that it is not prepared or capable of addressing and curing any shortfall of gasoline should this contingency occur. *See* Comments of Chairman Caliboso at the House of Representatives Legislative Briefing. As a result, consumers in rural areas of the State face a serious risk of supply shortages leaving them without access to gasoline.

D. ICF's Plan for Monitoring and Enforcement

Haw. Rev. Stat. Chapter 486H does not articulate a plan for monitoring and enforcement of the price cap law. Rather, it delegates this responsibility to the PUC which is charged with developing an implementation plan for publishing, monitoring, and enforcing the price cap law. *See* Haw. Rev. Stat. Chapter 486H; Order No. 21525 at pp. 2-4.

But ICF's recommendations as set forth in Section 7 of the Report stand as an unstudied proposal, wrought with obvious pitfalls, that hold little relationship to the practical realities routinely faced in the petroleum industry. At a minimum, ICF's recommendations are incomplete, underscoring the critical need for more time to design and implement a proper and workable system for monitoring and enforcement.

First, ICF proposes that parties submit data on all wholesale gasoline transactions identifying the appropriate zone, class of trade (DTW, rack, bulk), date, volume, and grade, price, customer, and method of delivery. Said data is to be entered by the parties immediately after the transaction but no later than a week after the close of the delivery week. *See* ICF Report at pp. 68-69. This is a significant administrative burden on the parties, as there will be numerous transactions a day to be inputted by the parties. While ICF acknowledges that "there will be cost impacts to marketers and suppliers" for complying with this system, it has not performed any analysis to determine what these cost impacts actually will be. *See* ICF's Response to SHELL-IR-65. Moreover, ICF specifically acknowledges that its current recommendations do not "include any mechanism for suppliers and marketers to recoup any of the costs that will be incurred for" compliance. Although ICF acknowledges that "there may be a rationale to include an assessment of [those] costs[s] in the cap formula[,]" the price cap formulas currently being discussed have no provision to accommodate this factor. *See* ICF's Response to SHELL-IR-66; ICF's Response to SHELL-IR-67.

Second, the issue of the verifying the accurateness of the information to be published on ICF's proposed website is of critical importance to Shell. Haw. Rev. Stat. § 486H-13(l) imposes "civil penalty, for each violation, equal to three times the amount of the overcharge or $250,000, whichever is greater, and shall be liable for the costs of the action and reasonable attorney's fees as determined by the court."

However, when asked whether its recommended database tool in § 7.3 of the ICF Report contains any systems to verify the accurateness of the information being used to calculate the price caps, ICF acknowledged that while this would be "ideal[,]", it had not "specifically recommend the database tool contain any systems to verify the accurateness of the information that is being utilized to calculate the gas caps, however, this would be a key criteria of the assessment process." *See* ICF's Response to SHELL-IR-69.

Moreover, ICF recognizes "that in using external sources for pricing information such as Platt's etc. there are situations where *there are errors that arise from in the data that is published*[.]" *See* ICF's Response to SHELL-IR-70. Nevertheless, ICF concedes that it has not yet developed a default provision or system in place to promptly address these errors. Interestingly, ICF even seems to accept that any default system will still not be able to catch *all* errors that arise from using multiple alternative sources in their published caps:

> The default procedure would have to be triggered from a tool such as described in IR-69 b. *Once identified*, Platt's would be contacted to assess and correct.
>
> ICF notes that Platt's has indicated to us (email John Kingston/Tom O'Connor) that the four key prices used in the weekly calculation have a lower than normal error incidence. Moreover, since the USGC 87 and Singapore 92 price quotes are used in so many contracts, any error is *normally* identified in a about a day and correct. This in fact may catch *most* of the limited errors before the weekly calculations are made.

ICF's Response to SHELL-IR-70. While ICF's response covers *most* errors under *normal* conditions, it does not capture *all* errors under all conditions, including conditions that are *not normal*. ICF's also admits that "[n]one of [its] recommendations as set forth in § 7.0 of the Report take into consideration potential liability issues that may arise from the posting of incorrect information." *See* ICF's Response to SHELL-IR-71.

Based on all of these factors, and the fact that Haw. Rev. Stat. Chapter 486 *does not* provide for clear rules to ascertain what constitutes a "knowing[]" violations of this statute, Shell believes that further changes to the law are required. At a minimum, a recommendation to more forward with enforcement of the gas cap law is unreasonable under the circumstances.

E. The Pricing Impact

Notwithstanding the attempts by the 2004 Legislature (via the amendments to Act 242) to broaden the purported legitimate state interest to support this law, it is clear that the overriding purpose for Haw. Rev. Stat. Chapter 486H has always been to lower gasoline prices in this State.[5] The 2004 legislative materials, and the committee reports regarding Act 242 confirm this:

> The purpose of this bill is to improve upon and make more effective the goal of ensuring that Hawaii consumers are charged a fair price by making certain amendments to Act 77, Session Laws of Hawaii 2002, ... *See* House Standing Committee Report 1184-04 (2004).
>
> The purpose of this measure is to amend certain provisions of Act 77, Sessions Laws of Hawaii 2002, relating to the imposition of limits on the pre-tax wholesale and retail prices of regular unleaded gasoline in the State. In 2002, the Legislature found that the gasoline market in Hawaii was dominated by an uncompetitive oligopoly. Major oil producers were realizing profit margins in the State that were much higher than those in other regional markets on the Mainland. *The end result was that consumers in Hawaii were consistently paying the highest gasoline prices in the Nation.*

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[5] Shell acknowledges that the Legislature sought bolster its defenses to a constitutional challenge to this law by amending the public purpose of the Act to "enhance the consumer welfare by fostering the opportunity for prices that reflect and correct with competitive market conditions[,]" but not necessarily "to guarantee lower gasoline prices." *See* 2004 Session, Act 242 § 1. However the question that should be asked is if a state interest can only be deemed "legitimate" if it involves the public health, safety or welfare, *see State v. Mallan*, 86 Hawaii 440, 452, 950 P.2d 178, 190 (Haw. 1998), how is the "consumer welfare" enhanced unless the law always results in lower gasoline prices for consumers. At a minimum, serious questions exist as to whether the law to be implemented as recommended by ICF can withstand constitutional scrutiny in view of the fact that it does not guaranty lower gasoline prices for consumers.

> *Your Committee on Commerce, Consumer Protection, and Housing finds that the situation remains unchanged. Hawaii's gasoline consumers continue to pay the highest gasoline prices in the country*, without any acceptable justification, while gasoline prices have fallen considerably on the Mainland. *Accordingly, strong and effective measures are needed to bring relief to Hawaii's consumers from high gasoline prices.* Meanwhile, the petroleum industry and critics of Act 77 have failed to offer any effective and meaningful alternatives to Act 77 or to the contents of this measure. *While continuing to support the intent and content of Act 77, your Committee believes that Act 77 can be improved upon and made more effective in reaching its goal of lower gasoline prices.*

Senate Standing Committee Report 2429 (2004) (emphasis added).

Notwithstanding this, the ICF Report confirms what may be the most troubling aspect of this law – that the implementation of its recommendations *will not* necessarily lower gasoline prices for consumers:

> These changes should put Hawaii consumers on a relatively better gasoline pricing basis with the rest of the United States, however, *that does not mean Hawaii consumers will see significant change in gasoline prices at the pump. The reasons for this include*:
>
> 1) The wholesale Gas Caps affect wholesale prices only. While there is a good deal of competitiveness at the retail (street price) level in Hawaii, it must be recognized that *retail marketers are under no obligation to lower street price if wholesale prices are reduces.*
>
> 2) *Hawaii's location places a premium on product prices.* Wholesale product prices need to be high enough to cover the cost of freight and source gasoline price.
>
> 3) *Due to logistics, geography, and scale, the cost to supply the zones outside Oahu will be higher (in some cases significantly).*
>
> 4) *Hawaii's gasoline taxes are among the highest in the United States*, averaging about 57 cpg Federal, State, and City taxes. The US average is 44 cpg, so Hawaii consumers pay about 13 cpg above the US average.

ICF Report at p. 74 (emphasis added).

The ICF study specifically confirmed situations where the ICF recommended formula actually resulted in higher prices for consumers. For example, Exhibit 3.19 of the ICF Report shows at least five occasions during the period from January 1999 to December of 2004 where ICF's recommended gas cap surpasses the actual price of wholesale gasoline of Wholesale Unleaded gasoline on the island of Oahu: (1) from the 4th quarter of 1999 to the 1st quarter of 2000; (2) in the 2nd quarter of 2002; (3) in the 1st quarter of 2003; (4) in the 1st and 2nd quarter of 2004; and (5) in the 4th quarter of 2004. *See* ICF Report Exhibit 3.19.

Another example is contained in Exhibit 3.20 of the ICF Report. Exhibit 3.20 illustrates the Rack price of gasoline under the ICF formula vs. the Oahu Wholesale Unleaded DTW prices from 1999-2005. This also shows instances where ICF Gas Cap prices exceeded the actual price of Wholesale Unleaded gasoline.

As the previous two examples indicate, ICF and the Legislature cannot guarantee that the recommended gas caps will reduce wholesale prices of gasoline for consumers. Conceptually, the ICF methodology for approximating "market conditions" is based entirely on variables that, in most cases, have little correlation with the Hawaii gasoline market and upon which little control can be exerted. The result is that significant changes in any of those variables will alter the price of gas in Hawaii – in some cases, making gasoline more expensive for its citizens.

F. <u>The Gasoline Price Cap Law As Currently Drafted And As Recommended By ICF Gives Rise to Likely Legal Challenges</u>

The gasoline price cap law gives rise to likely legal challenges:

First, as indicated above, the gasoline price cap law as implemented by Act 242 fails to meet substantive due process requirements because it is not rationally related to its stated legitimate state interest. The purpose of the gasoline price cap is to "enhance the consumer welfare by fostering the opportunity for prices that reflect and correlate with competitive market conditions." As demonstrated above, the gasoline price cap is not rationally related to its purpose of "enhancing consumer welfare" because: a) it does not guarantee lower gasoline prices; b) it endangers the supply of gasoline to consumers in rural areas of the neighbor islands; and c) it endangers the supply of gasoline to all consumers by limiting the ability of wholesalers and jobbers to make a fair return on their investments. This failure renders the law constitutionally invalid. *See Lingle v. Chevron U.S.A., Inc.*, 25 S.Ct. 2074, 2087 (2005) (concurring opinion of J.Kennedy stating that "today's decision does not foreclose the possibility that a regulation might be so arbitrary or irrational as to violate due process").

Second, the Legislature's failure to comply with its own law in implementing the requirements of Act 242 give rise to Federal and State procedural due process claims by various parties, including retailers and marketers on the neighbor islands. The present public hearings before the PUC are insufficient to cure the procedural due process defects because the PUC is without power and authority to address the problems raised by the people testifying at the hearings. "The basic elements of procedural due process of law require notice and an opportunity to be heard at a meaningful time and in a meaningful manner before governmental deprivation of a significant property interest." *See Sandy Beach Def. Fund v. City Council*, 70 Haw. 361, 378, 773 P.2d 250, 261 (1989).

Third, constitutional claims arise from the improper separation of powers and the improper delegation of legislative authority. Haw. Rev. Stat. § 486H-13 gives an enormous amount of unbridled discretion to the PUC to determine "more appropriate" baseline and adjustment factors. This discretion leaves HRS § 486H-13 open to challenges under the nondelegation doctrine. *See Touby v. United States*, 500 U.S. 160, 165 (1991) (the legislature must "lay down by legislative act an intelligible principle to which the person or body authorized to [act] is directed to conform); *see also Application of Kauai Elec. Division of Citizens*, 60 Haw. 166, 590 P.2d 524 (Haw. 1978). No guidance was given to the PUC regarding how to determine what is "more appropriate". To wit, the PUC's consultant has taken that broad discretion and expanded the gasoline price cap from 4 adjustment factors and in 8 zones and come up with 96 different gasoline price caps that still fail to address the impact to the supply of gasoline, the effect of ethanol legislation and the concerns of jobbers and retailers servicing rural areas of the neighbor islands. Without "intelligible principles" for guidance, the PUC and its consultant have been unable to provide a "more appropriate" gasoline price cap that meets the questionable legislative purpose.

Fourth, the statute as written and as recommended by ICF is subject to constitutional challenge on the basis of Haw. Rev. Stat. § 486-13's requirement to have the parties produce unlimited information to the PUC without protection for trade secret information. HRS § 486H-13(j) requires every manufacturer, wholesaler, or jobber to produce all documents and data the PUC may require and imposes a $50,000/day penalty for failing to cooperate. This requirement violates the due process rights of these businesses because it fails to provide any opportunity for notice and hearing. It also results in potential violations of the Takings Clause given the significant economic impact to these businesses from the taking and disclosure of their trade secrets for public use without compensation. *See Lingle v. Chevron U.S.A., Inc., 125 S.Ct. 2074 (2005).*

Last, the legislation as currently drafted and as recommended by ICF creates a constitutional claim for a violation of the U.S. Constitution's Dormant Commerce Clause as set forth under Article I, Section 8, Clause 3. HRS § 486H-13 as currently drafted utilizes a baseline averaging prices from Los Angeles, the Gulf Coast and New York Harbor. Moreover, ICF also recommends utilizing a baseline average price that will inevitably create economic impacts in other States. Consequently, HRS § 486H-13 and the baseline recommended by ICF in its Report affects the pricing decisions of refiners who operate in those markets outside of Hawaii. As such, the proposals for baseline sources in HRS § 486H-13 and as recommended in the ICF Report violates the restrictions imposed by the U.S. Constitution's Commerce Clause, Article I, Section 8, Clause 3. *See Healy v. Beer Institute*, 491 U.S. 324 (1989).

To proceed with implementation of this obviously flawed law is to invite a significant legal challenge by the many affected parties in this State.

IV. RECOMMENDATIONS

A. The PUC's Report to the Governor and Legislature and the Governor's Emergency Powers

Under Haw. Rev. Stat § 486H-13(n), the PUC "shall report to the governor and the legislature, in a timely manner, on any significant aberrations, trends, or conditions that may adversely impact the gasoline consumers in the State." Haw. Rev. Stat. § 486H-13(n) (emphasis added). Thus, where the PUC knows of a condition that "may" adversely impact gasoline consumers, then it *must* make a timely report to the Governor and Legislature.

The PUC's report to the governor is crucial in that it compels the governor to determine whether to use her "emergency powers" to suspend the gasoline price caps under Haw. Rev. Stat. § 486H-15:

> (a) Notwithstanding any law to the contrary, *the governor may suspend, in whole or in part, section 486H-13 or any rule adopted pursuant to that section whenever the governor issues a written determination that strict compliance with the section or a rule will cause a major adverse impact on the economy, public order, or the health, welfare, or safety of the people of Hawaii.* In the written determination, the governor shall state the specific provision of the section or rule that strict compliance with will cause a major adverse impact on the economy, public order, or the health, welfare, or safety of the people of the State, along with specific reasons for that determination. The governor shall publish this determination in accordance with section 1-28.5. The suspension shall take effect upon issuance of the written determination by the governor.

Haw. Rev. Stat. § 486H-15 (emphasis added).

The PUC's report to the Governor also facilitates her use of emergency powers under Haw. Rev. Stat Chapter 125C. Haw. Rev. Stat. Chapter 125C gives the governor "the clear authority, when shortages of petroleum products occur or are anticipated, to control the distribution and sale of petroleum products in this State, to procure such products, and to impose rules that will provide extraordinary measures for the conservation of petroleum products and for their distribution and sale in an orderly, efficient, and safe manner." Haw. Rev. Stat. § 125C-1 (emphasis added); *see also* House Standing Committee Report 687 (1975) ("The purpose of the bill is to grant the Governor clear authority to control the distribution of petroleum products when shortages in supply occur or are anticipated . . . . As was demonstrated during the energy crisis of late 1973 and early 1974, the State government must act before events reach the "emergency" stage.") (emphasis added).

Under HRS chapter 125C, the governor's powers include but are not limited to:

1. The power to determine when a petroleum "shortage" exists (Haw. Rev. Stat. § 125C-2);

2. The power to adopt rules to "[c]ontrol the retail distribution and sale of petroleum products" when a petroleum "shortage" exists (Haw. Rev. Stat. § 125C-3); and

3. The power to "make investigations and surveys for the purpose of ascertaining facts [via reports, statements, subpoenaed witnesses and records, etc.] to be used in administering this chapter." (Haw. Rev. Stat. § 125C-9).

In addition, under Haw. Rev. Stat. § 125C-4, the Governor must plan for an anticipated "shortage" by establishing administrative rules which become effective when a "shortage" occurs. *See* House Standing Committee Report 483-86 (1986) ("rules to insure that petroleum products are made available to the public in an orderly and safe manner should be promulgated before an emergency arises.").

Accordingly, a report from the PUC (as required by Haw. Rev. Stat. § 486H-13(n)) regarding a significant condition that "may" adversely impact gasoline consumers should convince the governor to conduct a investigation/survey under Haw. Rev. Stat. Chapter 125C to determine what rules should be adopted and implemented before a "shortage" or other adverse impact caused by any such reported condition arises. The Governor should also adopt rules to address the anticipated shortages caused by such conditions.

B. Given The Present Circumstances It Is Appropriate For The PUC To Recommend That The Governor Invoke Her Emergency Powers To Suspend The Implementation Of The Gas Cap Law

For the reasons set forth in great detail above, the prospect of having Haw. Rev. Stat. Chapter 486H implemented - either in its current form, as recommended by ICF, or in any other fashion – gives rise to serious, immediate risks of major adverse impacts on gasoline consumers in this State, and to the overall economy, welfare, and safety to the people of Hawaii. In view of these factors, it is appropriate for the PUC to report to the Governor to recommend that she invoke her emergency powers to suspend the implementation of Haw. Rev. Stat. Chapter 486H. As established by the extensive record of this case, there are simply too many known risks and unanswered questions to allow any form of this law to take effect. While there are many reasons for so doing, the following are major points to consider.

As established above, a fundamental reason why the law must not be implemented is the confirmed risk to the available consistent supply of gasoline within the State that will result from gas cap implementation combined with the utter failure to take any appropriate action to understand and address these risks prior to implementation of the proposed gas cap.

The confirmed impact of ethanol blending, both standing alone, and when coupled with the significant risk to supply, also cuts against implementation. Through this investigative process, the PUC's own expert now states that *its current formula for calculating gas caps will have to be changed within 9 months of the scheduled start of the bill*. Worse, ICF also admits that *it does not know how that gas cap calculations will be done once ethanol blending starts*. In view of this, ICF now recommends *against full implementation of the law*, asking that it be only phased in on a "calculation and monitoring basis." This stunning concession should serve as a red flag to the PUC that other problems will likely appear, given the complexity of this project and the rushed timeframe to complete it.[6] Indeed, if the PUC's own consultant cannot in good conscience recommend full implementation of the law, it would be inappropriate for the PUC to recommend otherwise.

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[6] Shell notes that subsequent to the publication of its Report, after going through the discovery process, ICF has also reversed itself on key aspects of their initial calculation and recommendation. Indeed, even at this late date, ICF does not appear to have formal final positions on many material aspects of their initial recommendations. *See* Section II.C. *supra*.

The significant supply risk facing the neighbor islands and remote areas, as evidenced by the ICF Report and the public testimony offered by jobbers, and retailers during the public meetings, also is a concern that must be understood and addressed before any law can be implemented.

Finally, related to this risk is the inequity inherent in the Legislature's unexpected failure in 2004, to convene the neighbor island legislative task force and the fulfillment of the task force's duties as required under Act 242. The requirements of Section 7 of Act 242 are mandatory and have not been repealed, altered and/or amended by the Legislature in anyway since its enactment. As the governmental agency responsible for carrying out and implementing Act 242/Haw. Rev. Stat. Chapter 486H, the PUC must follow the law and recommend against implementation unless and until all the requirements of Act 242 are fulfilled and the supply risks to the neighbor islands are properly addressed – either by appropriate rulemaking or by amendments to the statute itself.

These critical factors affecting the available supply of gasoline in this State, combined with: a) the constitutional implications that will inevitably ripen with the implementation of the law; b) the incomplete and yet-untested proposal for monitoring and enforcement of this law; and c) perhaps most problematic - *the stark reality that the price caps may even lead to higher prices for consumers at the pump* – clearly constitute conditions that may adversely impact the gasoline consumers of this State. *See* Haw. Rev. Stat. § 486H-13(n).

The PUC initiated this matter as an investigative docket in order to determine the appropriateness of the proposed price cap law, as well as to fulfill its statutory duty to timely advise the Governor and Legislature of any aberration or condition that would adversely affect the consumers of this State. Through this investigative process, much has been learned. The PUC has been apprised of the flaws and dangers that will likely result if the law is passed. It has also received the benefit of hearing from the people themselves, who will personally face substantial difficulties should this law be allowed to go into effect. This process has even led to the PUC's consultant reversing itself on its initial plans for implementation. Unfortunately, the law remains on the books and was not repealed. It is indeed remarkable that this law of Statewide concern – to which its provisions are still being finalized, and to which the consultant retained to implement it now recommends against full implementation – now stands at the precipice of being implemented; flaws and all.

The PUC now stands in the position of being able to steer this State away from the storm and the adverse consequences that will inevitably arise should this law take effect on September 1st. The PUC now knows of these adverse conditions and should recommend to the Governor that she invoke her emergency powers to suspend the scheduled implementation of this law, pursuant to Haw. Rev. Stat. § 486H-15(a). At a minimum, the PUC should recommend that the governor conduct an investigation/survey under HRS chapter 125C so the governor can adopt rules to address the anticipated shortages caused by this condition. Shell believes that there is a sufficient basis for this recommendation, and that to do so will be in the best interest of the people of Hawaii.

Shell does not make this recommendation lightly and it does so with the full appreciation for the political strength and resolve necessary to follow the suggested course of action. Shell recognizes the desire of all gasoline consumers to achieve the lowest reasonable prices. Shell is committed to offering the highest quality gasoline at fair prices and believes this objective is best achieved through competitive markets.

Shell stands ready to work with the PUC and Hawaii's elected officials to reach a satisfactory conclusion to this matter.

DATED: Honolulu, Hawaii July 1, 2005.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the above document was duly served upon the following parties in the manner described at their following last known addresses:

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